



NOVEMBER 2010

Republicans made big gains on Election Day, taking over the House of Representatives in the Congress that will be seated in January and narrowing the Democratic majority in the Senate. They are expected to take aim at the health care reform and financial regulations reform laws that were enacted this year, but they are likely to have a difficult time making major changes to either one. In mid-November, deficit reduction was in the headlines, with the co-chairs of a presidentially-appointed commission releasing their proposal to revise the nation's taxes on spending and move the federal government not out of the red, but at least closer to the black. Two members of the commission, meanwhile, signed on to competing plans. (Both the co-chairs' proposal and one of the alternatives would force all newly-hired public employees to participate in Social Security.)

ISSUES AND EVENTS

Competing Deficit Reduction Plans Offered

The deficit reduction plan offered in early November by the chairs of President Obama's debt commission has received a mostly cool response, but it at least was flattered by imitation (of sorts).

Clinton White House Chief of Staff Erskine Bowles and former Republican Sen. Alan Simpson of Wyoming have released a plan that would reduce federal budget deficits by \$3.8 trillion over 10 years by, among other things, eliminating the income tax exclusion for employer-provided health insurance; ending the mortgage interest tax deduction; raising the Social Security retirement age; increasing the amount of income subject to Social Security taxes; revising the Social Security benefit formula; changing the calculation of Social Security cost-of-living allowances; requiring all newly-hired state and local workers to participate in Social Security after 2020; reforming Medicare, Medicaid and other federal health care programs; and cutting defense, farm subsidy and other spending.

The Bowles-Simpson plan would reduce the deficit to 2.2 percent of GDP by 2015, a level that is considered to be much more sustainable than the current level of 8 percent. The national debt, which now exceeds 60 percent of GDP, would fall to about 40 percent

by 2037. (Under current law, it is projected to rise to 80 percent by that point.) In addition, it would reduce tax rates and secure Social Security solvency for 75 years.

Bowles called the plan a “starting point” for discussions among the 18 members – nine Democrats and nine Republicans – of the National Commission on Fiscal Responsibility and Reform, who have been charged with delivering a deficit reduction plan to Congress by Dec. 1. In order for a commission proposal to be submitted to lawmakers for an up-or-down vote, 14 members must agree to the package of reforms.

The difficulty of securing that super-majority was underlined shortly after the release of the plan when two Democratic members of the panel released their own deficit reduction proposals.

An independent group that includes many former high-ranking government and private sector officials and is led by Clinton White House Budget Director Alice Rivlin, a commission member, and former Senate Budget Committee Chairman Pete Domenici, R-N.M., offered its own proposal on Nov. 17 that would reduce the deficit by \$5.9 trillion over nine years and \$15.5 trillion over 15 years. The plan from the Bipartisan Policy Center would, among other things, impose a 6.5 percent national sales tax; eliminate most tax deductions and credits – including the exclusion for employer-provided health care, but not the one for mortgage interest, which would be overhauled – while reducing tax rates; reform Medicare and Medicaid; reduce farm subsidies; freeze domestic discretionary spending for four years and limit increases to the rate of economic growth after that; freeze defense spending for five years and limit increases to the rate of economic growth after that; increase the amount of income subject to Social Security taxes; change the calculation of Social Security cost-of-living allowances; revise the Social Security benefit formula, cutting benefits for the top one-fourth of earners; and require all newly-hired state and local workers to participate in Social Security after 2020.

It would also suspend the Social Security payroll tax for one year, a \$650 billion measure that is intended to stimulate the economy.

“The status quo is not an option, and everyone must sacrifice a little in the common interest,” Domenici and Rivlin wrote in *The Washington Post*. “Our economic security and our future prosperity depend on living within our means.

Rep. Jane Schakowsky, D-Ill., another commission member, presented a plan on Nov. 16 that would, among other things, make large cuts in defense spending; end the Bush tax cuts for higher-income earners; tax capital gains and dividends as ordinary income; eliminate some corporate tax breaks; and create a new energy tax with a cap-and-trade system of emissions regulation. As for Social Security, the plan would eliminate the payroll tax cap for employers and raise it for employees. The proposal is projected to cut the deficit by \$441 billion in 2015, with one-fourth of that amount coming from the Defense Department budget.

"Lower and middle-class Americans did not cause the deficit," Schakowsky said in a jab at the Bowles-Simpson plan. That plan, she added, "would have serious consequences for lower and middle-class Americans, and that is why I cannot support it."

Schakowsky probably will not be the only person on the panel who is reluctant to support a plan that targets two of the most popular tax code provisions – the home interest deduction and the employer-provided health care exclusion – and makes significant changes to Social Security. The commission's leaders, however, say they will push hard to get 14 votes.

"In my viewpoint, the people are way ahead of the members of Congress on this," Bowles said. "I think the era of deficit denial is over. ... People are either going to face up to this issue today, or I'm telling you, the markets are going to force them to face up to it in a couple of years. And when they do, I can guarantee you it will be swift, and it will be severe."

Mandatory Social Security Coverage Included in Deficit Reduction Proposals

Both the deficit reduction plan drafted by the leaders of President Obama's debt commission and one recently released by an independent group would achieve part of their budgetary goals by requiring all newly-hired state and local workers to participate in Social Security after 2020.

The plan from Clinton White House Chief of Staff Erskine Bowles and former Republican Sen. Alan Simpson of Wyoming, co-chairs of the National Commission on Fiscal Responsibility and Reform, project that mandatory coverage would cover 8 percent of Social Security's \$5.3-trillion, 75-year shortfall.

Meanwhile, a plan from the Bipartisan Policy Center, an independent group that includes many former high-ranking government and private sector officials and is led by Clinton White House budget director Alice Rivlin, a member of the Bowles-Simpson commission, and former Senate Budget Committee Chairman Pete Domenici, R-N.M., endorses the same measure to save the federal government \$566 billion through 2040.

"Incorporating these new government employees reflects the goal of increasing the universality of Social Security, which was pursued throughout the second half of the 20th century," the plan stated. "Placing them in the system will provide better disability and survivor insurance protection for many workers who move between government employment and other jobs."

Forced coverage would require state and local governments to pay billions of dollars in payroll taxes for employees who do not now participate in Social Security, an expense that studies have concluded could lead to tax increases, cuts in vital government services and the destabilization of public pension funds. The center's plan, to some extent, acknowledges the financial challenges that this measure would create for states and localities, noting that implementation is delayed until 2020 "due to the poor fiscal

condition of state and local governments, and the significant underfunding of public employee pensions.”

“This grace period will give governments time to shore up and reform their pension systems,” the plan stated. “Over the long run, covering all of their employees under Social Security could help states and localities get their fiscal houses in order through transitioning to more sustainable pension programs.”

The plan also would impose new reporting mandates on public funds, requiring them to share data with the Social Security Administration until all state and local workers were in the program.

HHS Sets Rules on Spending by Insurance Companies

The U.S. Department of Health and Human Services (HHS) on Nov. 22 issued regulations that will require insurance companies to spend 80 to 85 percent of premiums on patient care and quality improvements.

The regulations implement the “medical loss ratio” provision of the Patient Protection and Affordable Care Act that became law this year.

“Thanks to the Affordable Care Act, millions of Americans will get better value for their health insurance premium dollar,” HHS Secretary Kathleen Sebelius said. “These new rules are an important step to hold insurance companies accountable and increase value for consumers.”

Critics have charged that insurers spend too much on administrative costs – including executive salaries – and take profits that are too large. The new regulations, which will be effective in 2011, will impose financial disclosure requirements on insurance companies and establish the minimum percentage of revenues that are to be spent on care-related expenses at 80 percent for individual and small business plans and 85 percent for large company plans.

Starting in 2012, insurers that fail to meet the medical loss ratio standard will have to provide rebates to consumers. HHS estimates that as many as 9 million people could be eligible for rebates totaling as much as \$1.4 billion. Rebates in the individual market could average around \$164, the department estimated. Some observers, though, have pointed out that the regulations could backfire since they could encourage insurers to raise premiums.

The regulations reflect recommendations made in October by the National Association of Insurance Commissioners and include several exceptions, such as for insurers with fewer than 1,000 enrollees and for providers of bare bones “mini-med” plans as are offered by McDonald’s and certain other employers. Also, states can request exemptions for providers of individual plans, as Maine, Iowa, Georgia and South Carolina have already done. Insurers, however, want exemptions also to be allowed for providers of employer-sponsored plans, and they want to expand the list of expenses that are considered care-related.

"These regulations acknowledge the potential for individual insurance market disruption and take a first step toward minimizing such disruptions," America's Health Insurance Plans President and CEO Karen Ignani said. "The potential for disruption to employer-provided coverage should also be acknowledged and addressed. In addition, more consideration needs to be given to the cost of federally-mandated investments in modernizing claims coding and the value of health plans' programs to prevent fraud."

As the regulations are now written, the cost of claims coding modernization and anti-fraud efforts would not count toward the required 80 or 85 percent.

California already requires insurers to spend 70 percent of premiums on medical benefits.

New CMS Administrator: Health Care Reform 'Best Opportunity ... in a Generation'

The new head of the Centers for Medicare and Medicaid Services (CMS) on Nov. 17 strongly defended the health care reform law before a congressional panel, saying that it "has already begun to help bring better quality care to the American people."

CMS Administrator Donald Berwick recounted several of the major Medicare-related provisions of the law to the Senate Finance Committee and said that, as a result of the Patient Protection and Affordable Care Act, "Medicare's long-term sustainability is stronger than ever as a result of efficiencies, new tools, resources to reduce waste and fraud and slower growth in Medicare costs."

"The Affordable Care Act includes unprecedented new tools that will enable us to reinvigorate our nation's focus on the quality, value and outcomes of care, and help the public and the private sector produce a new system that is better for patients, families, communities and the health care workforce," Berwick said. "These innovative provisions will enable CMS to work with our partners in the private sector to improve care coordination, increase patient safety, offer beneficiaries more information and more control over their care, and achieve better outcomes."

President Obama put Berwick in the CMS post with a recess appointment during Congress' Independence Day break, citing Republican intransigence and the failure of the Senate to schedule a confirmation hearing following his nomination in April. GOP lawmakers had raised concerns about comments Berwick has made regarding the need to ration health care, cap spending and "reduce the total supply of high-technology medical and surgical care."

"I think he's probably a pretty fine man, but then again, I look at some of the comments he's made. ... Some of them are ridiculous," Sen. Orrin Hatch, R-Utah, a panel member, said after the hearing, though he did not appear to be referring to anything Berwick told the Finance Committee.

Berwick seemed to try to address the concerns about rationing, saying, "To be absolutely clear, I am talking about reducing costs while improving the quality of care individuals receive," and "Every person in America, and certainly every beneficiary of

Medicare and Medicaid, should be able to get all the care they want and need, when and how they want and need it.”

Berwick also cautioned against GOP attempts to repeal part or all of the reform bill.

“I can’t think of a worse plan than repealing this bill,” he said. “It is the best opportunity [to improve health care] I think we’ve had in a generation.”

Separately, Rep. John Boehner, R-Ohio, who is expected to be Speaker of the House when Republicans take over that chamber in January, said in mid-November that GOP lawmakers will “move quickly enough” to hold a vote on repeal.

“We think that Obamacare ruined the best health care in the country, we believe it will bankrupt our nation, we believe it needs to be repealed and replaced with commonsense reforms to bring down the cost of health insurance,” Boehner said.

Repeal legislation would have a good chance of passing the House, but, as Senate Minority Leader Mitch McConnell, R-Ky., recently acknowledged, it probably would not clear the Democrat-controlled Senate and definitely would not escape an Obama veto.

Health Care Reform Will Raise Drug Prices for Some: CBO

Provisions in this year’s health care reform legislation that were intended to lower prescription drug prices could result in some people paying slightly more for medicines, according to a new study from the Congressional Budget Office (CBO).

The law requires drug manufacturers to provide new discounts and rebates on drugs purchased through Medicare and Medicaid, but this, the report noted, gives companies “an incentive to raise those prices to offset the costs of providing the new discounts and rebates.”

For prescriptions covered by the Medicare Part D drug benefit, these provisions are expected to boost prices by about 1 percent. This will mean different things for various categories of beneficiaries:

- Those in the low-income subsidy program will be largely unaffected because they have little or no cost-sharing.
- Those not in the low-income subsidy program who have spending below the benefit’s initial coverage limit will pay slightly more.
- Those not in the low-income subsidy program whose spending reaches the benefit’s “doughnut hole” will pay “substantially less,” because manufacturers are not expected to raise prices enough to offset the bill’s requirement that prices for those in the doughnut hole be discounted 50 percent.

- Those who reach the bill's "catastrophic" phase will pay slightly more because of their roughly 5 percent cost-share.

In Medicaid, the reform bill's provisions are expected to raise the prices paid by retail pharmacies by 4 percent, but new rebates are expected to lower prices for the Medicaid program.

A measure that creates a pathway for the approval of "follow-on biologics," meanwhile, would result in substantial savings, the CBO found, with prices for generic similars to biopharmaceuticals initially 25 percent below the costs of their brand-name counterparts and the savings rising to 40 percent after several years.

The study was conducted at the request of Rep. Paul Ryan, R-Wisc. Ryan is one of the leaders of the Republican effort to undo the health care reform law in the wake of GOP gains on Election Day, and he is expected to become chairman of the House Budget Committee when the next session of Congress is seated in January.

Health Care Reform Key to 1 in 6 Voters on Election Day: Poll

About one in six voters said health care reform influenced their vote on Election Day, with a majority of that group expressing opposition to the new law, according to a poll conducted by the Kaiser Family Foundation.

The factor cited most often as influencing votes - at 29 percent - was the economy. Health care reform was fourth at 17 percent. Among that 17 percent, 56 percent of voters had a "very unfavorable" view of the reform law, and 59 percent supported Republican candidates for Congress.

More than 80 percent of GOP voters want the law repealed - at least in part - while two-thirds of Democratic voters want it left alone or expanded. Even among the 24 percent of voters who support full repeal, though, a majority backs keeping the tax credits for small businesses that provide coverage to employees, nearly half want to continue to prohibit coverage denials based on pre-existing conditions, and 43 percent like closing the Medicare prescription drug benefit "doughnut hole."

Republicans, who campaigned heavily against the health care reform law, made large gains in the mid-terms elections, taking over the House of Representatives in the Congress that will be seated in January and narrowing the Democratic majority in the Senate.

RELATED NATIONAL AND INDUSTRY NEWS

Ex-Car Czar Settles Kickback Charges Related to N.Y. Pension Fund

The former investment firm executive who went on to lead the federal government task force that oversaw the restructuring of General Motors and Chrysler on Nov. 18 agreed to pay more than \$6 million to settle charges filed by the Securities and Exchange

Commission (SEC) that he participated in a kickback scheme that aimed to secure business from the New York State Common Retirement Fund.

The SEC charged that Steven Rattner, as principal of Quadrangle Group, pressured one of the firm's affiliates to distribute the DVD of a film called "Chooch" that was produced by New York State Deputy Comptroller David Loglisci and his brothers. Also, according to the SEC, Rattner caused Quadrangle to hire Henry Morris, the top political advisor and chief fundraiser for former New York State Comptroller Alan Hevesi, as a placement agent and pay him more than \$1 million in "finder's fees," even though Rattner and Quadrangle were already dealing directly with Loglisci. In addition, the SEC charged that Rattner arranged for a \$50,000 contribution to be made to Hevesi's re-election campaign.

The retirement fund invested \$150 million with Quadrangle, and Rattner collected \$3.2 million in fees, the SEC found.

Rattner agreed to settle the charges by paying \$6.2 million - disgorgement of the fees plus \$3 million in penalties - and consenting to an SEC order that bars him from associating with any investment firms or broker-dealers for at least two years. Rattner did not admit or deny the allegations. The settlement is subject to court approval.

"Rattner delivered special favors and conducted sham transactions that corrupted the Retirement Fund's investment process," said David Rosenfeld, associate director of the SEC's New York Regional Office. "The assets of New York state workers were invested for the hidden purpose of enriching Morris and Loglisci's brother."

Rattner still faces two lawsuits filed by New York Attorney General - and Governor-Elect - Andrew Cuomo that seek \$26 million and a lifetime ban from the securities industry, and he appears to be taking a more combative approach in those cases.

"While settling with the SEC begins the process of putting this matter behind me, I will not be bullied simply because the attorney general's office prefers political considerations instead of a reasoned assessment of the facts," Rattner said. "This episode is the first time during 35 years in business that anyone has questioned my ethics or integrity."

Quadrangle in April settled SEC charges against it by agreeing to pay a \$5 million penalty, but it also did not admit or deny any allegations. In addition, the firm settled charges with Cuomo by agreeing to pay \$5 million to the pension fund and \$2 million to the New York State Treasury.

Rattner was not named in the charges against Quadrangle because the investigation regarding his involvement had not been completed at that point. He and the firm have traded several accusations of wrongdoing in recent months. When it settled the cases against it, Quadrangle issued a statement calling Rattner's actions "inappropriate, wrong and unethical." Rattner, meanwhile, has filed an arbitration claim against Quadrangle and its partners that seek an undisclosed amount for "unlawful conduct and contractual breaches" and that alleges that, "to buy peace with Cuomo, the

Quadrangle parties falsely charged Mr. Rattner – both publicly and privately – with misconduct.”

CALIFORNIA CONGRESSIONAL DELEGATION NEWS

GOP Takes House, Narrows Gap in Senate, Targets Health Care Reform

Republicans on Nov. 2 won enough seats to take over the House of Representatives and significantly narrow the Democratic majority in the Senate, a change in power that is likely to have a significant impact on several issues of importance to CalPERS.

For the 112th Congress that will be seated in January, the GOP has a 242-192 seat majority in the House with one contest still to be decided, according to *The Washington Post*. In the Senate, Democrats will have 53 of 100 seats.

The Republican majority in the House means that several California lawmakers will lose key leadership posts, most notably Speaker of the House Nancy Pelosi. In addition, Rep. Henry Waxman will lose his chairmanship of the Energy and Commerce Committee – which has jurisdiction over health issues – and Rep. George Miller will no longer lead the Education and Labor Committee – which has jurisdiction over pension matters.

Republicans have indicated that one of their top priorities will be attempting to dismantle the health care reforms enacted this year. Given the Democratic majority in the Senate and President Obama’s veto power, however, major changes seem unlikely anytime soon. Rep. Paul Ryan, R-Wisc., who could become the House Budget Committee chairman next year, acknowledged as much a few days after the mid-term elections, saying repeal of the health care law probably would not be possible until 2013.

Until then, though, GOP lawmakers may use more indirect approaches to undermine the reforms, with some Republican lawmakers saying they will try to limit the funding available to government agencies charged with implementing the law. For example, they may try to tie the hands of the IRS to prevent it from enforcing the bill’s mandates on individuals and employers.

“If all of Obamacare cannot be immediately repealed, then it is my intention to begin repealing it piece by piece, blocking funding for its implementation and blocking the issuance of the regulations necessary to implement it,” House Republican Whip Eric Cantor of Virginia said. “In short, it is my intention to use every tool at our disposal to achieve full repeal of Obamacare.”

The more subtle Republican approach could be successful if the party can win a few Democratic converts in the Senate. While Obama still could reject any legislation, he might be more reluctant to use vetoes on spending bills that include just one or two provisions with which he disagrees. Even though the provisions could undermine portions of his signature domestic policy achievement, such vetoes could lead to a

legislative stalemate and, in the extreme, a federal government shutdown similar to the one that occurred in 1995.

As one former senior Democratic congressional aide observed, “House Republicans cannot enact legislation the president won’t sign. But the president cannot force them to appropriate money they don’t want to appropriate.”

Republicans are also expected to take aim at the financial regulations reforms enacted this year. Rep. Spencer Bachus, R-Ala., the ranking member on the House Financial Services Committee, said the GOP plans to apply “vigorous oversight” to the Obama administration’s actions in the banking and housing sectors.

“The Obama administration, we know what they’re going to do now that they’ve lost the House, they’re going to try to accomplish through regulation their radical leftist approach, and we’re not going to let the regulators do that,” Bachus said.

On Nov. 4, Bachus wrote to members of the Financial Stability Oversight Council – the panel created by the reform bill to oversee systemic risks – to express doubts about the “Volcker rule,” which would bar banks from investing more than 3 percent of their own money in hedge funds and private equity. If the rule is implemented aggressively, he wrote, “the damage to U.S. competitiveness and job creation could be substantial.”

Bachus is expected to succeed Rep. Barney Frank, D-Mass., as chairman of the committee next year, though Rep. Ed Royce, R-Calif., might also seek the post.

A GOP strategy that focuses on appropriations would face more limitations when applied to financial reform than health care reform since several of the key entities created by the financial bill – including the Financial Stability Oversight Council and the Consumer Financial Protection Bureau, which will watch over mortgages, credit cards and other consumer financial products, have independent funding sources.

Republicans opposed some key corporate governance provisions of the financial bill, including those related to proxy access and shareholder input on executive compensation, but it is unclear if GOP lawmakers will try to prevent the SEC from implementing and enforcing those measures.

Certain other CalPERS priorities that are pending before Congress are now highly unlikely to be enacted, including climate change legislation that would cap greenhouse gas emissions and a pro-shareholder legislative response to the Supreme Court’s Citizens United ruling, which struck down a long-time ban on political spending by corporations and unions.